

ST 00-0277-GIL

LEASING: 86 Ill. Adm. Code Section 130.2010(a), sets out the factors to be considered in determining whether a transaction is a lease or a conditional sales contract for purposes of the Retailers' Occupation Tax Act. (This is a GIL.)

December 6, 2000

Dear Xxxxx:

This letter is in response to your letter dated August 25, 2000 that we received on September 8, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at the Department's Website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

Please issue a private letter ruling on the following situation:

Facts:

An Indiana corporation (lessee) leased a large piece of machinery manufactured in Wisconsin and delivered to Indiana by common carrier.

Indiana sales tax was paid at the rate of 5% at the time of lease by the lessor.

The lease is stated as a 'true lease' on the lease documents. It is an 84-month lease with a purchase option at the end of the lease period in the amount of 38% of the original lease amount.

The machine was rented from the lessee on a month-to-month basis by a different Indiana corporation in the state of Indiana for a period of approximately 3 months.

The machine was then rented from the lessee on a month-to-month basis by a Illinois Corporation in the state of Illinois for several months.

Following the above, the machine was rented again by the Indiana corporation in the state of Illinois.

What is the Illinois tax liability for both Indiana corporations and the Illinois corporation?

You can apply the following principles to your questions about the sales/use tax consequences of leases of tangible personal property in Illinois. For general informational purposes we enclose a copy of 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases.

Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation and Use Tax purposes. Lessors are subjected to a Use Tax on their cost price of tangible personal property that they acquire to use by leasing under true leases in Illinois. This means lessors in Illinois encounter a front-end tax on value rather than an amortized tax on receipts. The only exception is automobiles rented for one year or less, which are subject to the Automobile Renting and Use Tax found at 35 ILCS 155/1 et seq.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. The lessor of tangible personal property under a true lease in Illinois is deemed the end user of the property to be leased. See, 86 Ill. Admin. Code 130.220. As the end user of tangible personal property located in Illinois, the lessor owes Use Tax on his cost price of such property. Normally, this tax is paid to an Illinois registered retailer at the time of purchase. If not, the lessor must self-assess and remit this tax to the Department. No tax is imposed on rental receipts by the State of Illinois. Consequently, the lessee incurs no tax liability.

Since the lessee does not incur Use Tax liability in lease situations, a lessor cannot charge a lessee "tax" in conjunction with a lease. A lessor may contractually require a lessee to reimburse the lessor for the lessor's Use Tax that is incurred by the lessor in regards to the purchase of the leased vehicle. The lessor may not term this charge a "tax" but may phrase this charge as a reimbursement of tax incurred by the lessor.

Under Section 130.2010(a), persons who purport to "lease" the use of property, but in fact sell such tangible personal property to nominal "lessees," are considered to be making conditional sales subject to Retailers' Occupation Tax. Such would be the case when the agreements contain nominal purchase options at the end of the lease term. In these situations Retailers' Occupation Tax is due on all the payments received by the "lessors." Interest or finance charges may be excluded from gross receipts if the books of the retailers ("lessors") clearly reflect the amounts of the payments attributable to financing. See 86 Ill. Adm. Code 130.420, enclosed.

Taxpayers who have properly paid sales tax with respect to the acquisition of tangible personal property that was properly due to another State will be allowed a "credit" against their Illinois Use Tax liability if they can demonstrate through documentation in their records that the tax was actually paid. This is because the Illinois Use Tax Act provides that in order to prevent actual or likely multistate taxation, the Use Tax does not apply to the use of tangible personal property in this State of tangible personal property that is acquired outside this State and caused to be brought into this State by a person who has already paid a tax in another State in respect to the sale, purchase, or use of that property, to the extent of the amount of the tax properly due and paid in the other State, 35 ILCS 105/3-55(d). See 86 Ill. Adm. Code 150.310(a)(3), enclosed.

The credit available where a taxpayer has already paid a tax that is properly due to another State on tangible personal property prior to its being brought into this State for use, is only for the amount of tax properly due and paid to the other State, and taxpayers remain liable for any difference between the tax already properly paid and that due under the Illinois Use Tax Act. For example, if a taxpayer properly pays a sales/use tax of \$300.00 on a purchase of a \$10,000.00 machine (i.e. 3% rate) to State X, the taxpayer would still have a net Illinois \$325.00 Use Tax liability when it brings the item into Illinois for the purpose of leasing because the Illinois rate of 6.25% would produce a liability

of \$625.00 against which the taxpayer can apply the \$300.00 credit for tax properly paid to the State of X.

Assuming that all leases are true lease situations, the general rule, as stated above, is that the lessor owes Use Tax on his cost price of property used for leasing purposes in Illinois. Assuming the lessor has satisfied this Use Tax liability, subsequent leases or sub-leases would generally not subject the lessor to further Use Tax liability, and sublessors and sublessees would incur no Use Tax liability.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Karl W. Betz
Associate Counsel

KWB:msk
Enc.